per week which was designated as a "fee." During this period the other personnel on petitioner's staff were compensated by salary. On March 29, 1957, petitioner instituted its "proportional pay plan," under which L. Ron Hubbard received, in lieu of salary, 10 percent of the gross income of petitioner. (Pet. App. A23–A24.)

During the 4-year period from June 1955 through June 1959, L. Ron Hubbard received from petitioner, HASI, the Congress of Scientologists and DCI [1] at least $108,584, including fees, royalties, and compensation for services of $77,460; payment for expenses incurred in connection with his services of $13,538; reimbursements for payments made by him on behalf of petitioner of $10,301; repayment of principal and payment on loans made by him to petitioner and to the New York organization of $5,893; and a loan of $1,391 from the petitioner in June 1959. These figures include $1,050 paid after the years here in issue and designated "back royalties," and $3,735 paid by the Congress of Scientologists shortly before petitioner was incorporated. The precise nature of the loans and reimbursed expenses mentioned above does not appear in the record. Also, petitioner provided during 1957–1958 and 1958–1959 a personal residence for the use of L. Ron Hubbard and his family. The household expenses of the residence were paid by petitioner and, in addition, petitioner supplied an automobile for the

[1] During the taxable years in issue the functions of the Congress of Scientologists and DCI were carried out by petitioner's employees on its premises (Tr. 333–334). Some of the functions of HASI were carried out by petitioner (Tr. 208).

use of Hubbard. Hubbard also received a percentage of the gross income (usually 10 percent) of the affiliated Scientology congregations, franchises, and organizations. (Pet. App. A23–A25.)

During the taxable years in issue petitioner paid Mary Sue Hubbard, the wife of L. Ron Hubbard, a salary of $85 per week until the adoption of the proportional pay plan. Petitioner also paid Mary Sue Hubbard $250 per month as rental for the use of a house located at 2315 15th Street, N.W., Washington, D.C. During the same years petitioner paid L. Ron Hubbard, Jr., a salary of $85 per week until the adoption of the proportional pay plan. From June 1957 through February 1959, petitioner issued weekly checks to Kay Hubbard (daughter of L. Ron Hubbard) totaling $3,242. There is no evidence in the record as to any services performed by Kay Hubbard for petitioner during those years. During the taxable years in issue, Mary Sue Hubbard received from all Scientology sources $29,635, including compensation for services, $15,863; rent for property owned by her and leased to petitioner, $10,685; loan, $800; reimbursement for expenditures on behalf of petitioner, $204; miscellaneous, $632; and payments attributable to debts of L. Ron Hubbard, Jr., $1,450. L. Ron Hubbard, Jr., received from all Scientology sources $13,510, including compensation for services $12,064; reimbursement for expenditures on behalf of petitioner, $219; and loans, $1,226. Kay Hubbard received from all Scientology sources a total of $3,242. (Pet. App. A25–A26.)

ARGUMENT

1. The Court of Claims correctly denied a tax exemption to petitioner because of its finding that a part of petitioner's net earnings inured to the personal benefit of L. Ron Hubbard and his family. That finding is based on substantial evidence. The applicable statutory provisions, *supra,* p. 2, explicitly provide that the exemption for a religious corporation does not apply if a part of its net earnings inures to the benefit of any private individual.

The court found that L. Ron Hubbard received $108,584 in fees, royalties, and compensation for services from petitioner and its three related organizations in the 4-year period in issue, plus the use of a personal residence and an automobile (Pet. App. A24–A25). Hubbard rendered only part-time service to petitioner.[2] During this period, his wife received $29,635 from such organizations, his daughter $3,242, and his son $13,510 (Pet. App. A26). In addition, L. Ron Hubbard received a share (usually 10 percent) of the gross income of affiliated Scientology congregations, franchises and organizations (Pet. App. A25).

[2] As petitioner notes (Pet. 16, n. 8), the court below did not find the amounts of time which L. Ron Hubbard devoted to and the money received from the related (HASI, DCI and the Congress of Scientologists) and affiliated Scientology congregations, franchises, and organizations (Pet. App. A25). Petitioner does not deny that Hubbard devoted time to these organizations and that he received payments from them. The court's conclusion that Hubbard's service to petitioner was part-time was therefore correct and is a factor evidencing private inurement. See *Mabee Petroleum Corp.* v. *United States*, 44 A.F.T.R. 1034 (N.D. Tex.), affirmed, 203 F. 2d 872, 875–876 (C.A. 5).

The court below found that loans and reimbursed expenditures paid to Hubbard of $17,586 (Pet. App. A8), to his wife of $13,185 (Pet. App. A10), to his son of $1,426 (Pet. App. A10) and to his daughter of $3,242, were largely unexplained. The court properly concluded that these payments were "disguised and unjustified distributions of [petitioner's] earnings" to individuals (Pet. App. A10). The fact that L. Ron Hubbard received a fixed 10 percent share of petitioner's gross income (Pet. App. A24), plus 10 percent of the gross income of its affiliated corporations (Pet. App. A25), is strong evidence that the benefits received were more like private gain from a commercial enterprise than reasonable compensation for services rendered to a religious organization In the 4-year period in issue, Hubbard's total compensation steadily rose along with the gross income of petitioner (Pet. App. A9), although there is no evidence that he increased his services to it. Under the agreement between petitioner and Hubbard, as petitioner's gross income increased, payments to Hubbard would increase without regard to services rendered. This constituted inurement to him within the meaning of Section 501(c)(3). See *Gemological Institute of America* v. *Commissioner,* 17 T.C. 1604, 1609–1610, affirmed *per curiam,* 212 F. 2d 205 (C.A. 9); *Gemological Institute of America* v. *Riddell,* 149 F. Supp. 128, 130–131 (S.D. Calif.); *Kemper Military School* v. *Crutchley,* 274 Fed. 125, 127 (W.D. Mo.); Rev. Rul. 66–104, 1966–1 Cum. Bull. 135; Rev. Rul. 69–279, 1969–1 Cum. Bull. 152; cf. *Birmingham*

Business College, Inc. v. *Commissioner*, 276 F. 2d 476, 480–481 (C.A. 5).

The court also found private inurement through an analysis like that regularly used by courts to determine the reasonableness of compensation to business officials under Section 162 of the Code (Pet. App. A6–A7). See *Enterprise Railway Equipment Co.* v. *United States*, 161 F. Supp. 590, 596 (Ct. Cl.). Petitioner, relying on the First Amendment, suggests that the test of inurement should instead be "whether the secular practices of the religion involved are markedly different from those of all other religions" (Pet. 14). But such a test does not reflect the plain meaning of the private individual inurement provision of Section 501(c)(3), and would not carry out the statute's intent. Moreover, petitioner does not state why its proposed special test for religious organizations would in fact be more "objective" than the usual individual inurement test used in the proceeding below.[3] Indeed, the court's careful consideration of Hubbard's steadily rising income and petitioner's unexplained loans, reimbursements and rental payments to him and his family (Pet. App. A8–A12) amply indicates the court's objectivity in the circumstances of this case.

2. Petitioner's other contentions are similarly without merit. Its argument (Pet. 20–22) that the explicit provisions in Section 503 of the Code concerning certain types of prohibited transactions preclude the ap-

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[3] Petitioner itself cites with approval (Pet. 17) several cases in which courts have applied the individual inurement test to religious organizations.

plication of the private individual inurement standard of Section 501(c)(3) to religious corporations would unwarrantably deny the latter provision its plain meaning. This argument was considered and rejected in *Kenner* v. *Commissioner,* 318 F. 2d 632, 635–636 (C.A. 7). Moreover, the Committee Reports accompanying the predecessor of Section 503 [4] indicate Section 503 does not foreclose use of a disqualifying activity for denying exemption under Section 501. H. Rep. No. 2319, 81st Cong., 2d Sess., pp. 124–125 (1950–2 Cum. Bull. 380, 469–470); S. Rep. No. 2375, 81st Cong., 2d Sess., pp. 123–124 (1950–2 Cum. Bull. 483, 571). Section 1.503(a)-1(a) of the Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.) reflects this congressional purpose. It provides that "The prohibited transactions enumerated in Section 503(c) are in addition to and not in limitation of the restrictions contained in section 501(c)(3) * * *."

Nor, as petitioner further contends (Pet. 21), need there be a "purpose" to engage in "private benefit" in order to effect the interdicted inurement. The examples from the regulation quoted by petitioner (Pet. 21) are not concerned with a situation involving actual inurement, as in the instant case.

Petitioner's contention that the burden of proof to show private inurement should be on the government (Pet. 18–20) is contrary to the very nature and purpose of Section 501(c)(3). The exemption from tax is made in recognition of the benefit which the public

[4] Section 3813, added to the 1939 Code by the Revenue Act of 1950, c. 994, 64 Stat. 906, Section 331.

derives from the activities of religious, charitable and educational organizations, and "is intended to aid them when not conducted for private gain." *Trinidad* v. *Sagrada Orden,* 263 U.S. 578, 581; see *Washington Ethical Society* v. *District of Columbia,* 249 F. 2d 127, 129 (C.A.D.C.). It is based on the theory that "the Government is compensated for the loss of revenue by its relief from financial burden which would otherwise have to be met by appropriations from public funds, and by the benefits resulting from the promotion of the general welfare." H. Rep. No. 1860, 75th Cong., 3d Sess., p. 19 (1939–1 Cum. Bull. (Part 2) 728, 742).[5] Engagement in religious activities does not *ipso facto* confer immunity from all financial burdens of government, including income taxes. *Follett* v. *McCormick,* 321 U.S. 573, 578; *Murdock* v. *Pennsylvania,* 319 U.S. 105, 112. And since tax exemption is a matter of legislative grace, petitioner has the burden of clearly establishing a right to it. See *Dickinson* v. *United States,* 346 U.S. 389, 395, referring to the ministerial exemption from military service.

Congress' clear intent was to exempt from tax only those corporations whose purposes and activities are directed to the public at large, and it cannot be doubted that it was within Congress' power to deny the exemption where the taxpayer could not show that its activities are exclusively devoted to the public rather than to private purposes. See *Better Business Bureau* v. *United States,* 326 U.S. 279, 282–283. As a

[5] This Committee Report accompanied the Revenue Act of 1938, c. 289, 52 Stat. 447.

practical matter, it would be impossible for the government to bear the burden of proving improper private inurement. It is the taxpayer who chooses the method and scope of its records. Here those records did not show the nature or purpose of several of petitioner's payments to Hubbard or his wife and family (Pet. App. A9–A11). Petitioner cannot utilize its failure to keep full and accurate records to obtain tax-exempt status. See *Cleveland Chiropractic College* v. *Commissioner*, 312 F. 2d 203 (C.A. 8). Moreover, neither L. Ron Hubbard, his wife nor his daughter, the persons who received the payments and were most likely to know their purpose, testified in the trial of the case.[6] The facts were peculiarly within their personal knowledge, and the petitioner's failure to call them illustrates the propriety of placing the burden of proof as to the expenditures on the petitioner.

Petitioner notes that the court below did not make findings of individual inurement with respect to each of the four years in issue and urges that for the fiscal year ended June 30, 1956, there was no such inurement (Pet. 23–24). The only major elements of inurement which were not present in that fiscal year were Hubbard's 10 percent proportional pay plan and his $125 per week "fee" (Pet. App. A24). For example, petitioner's payments of $85 per week to Hubbard's son, its payments of several kinds to his daughter, and its rental payments of $250 per month

[6] L. Ron Hubbard, Jr., testified on behalf of the government (Tr. 327).

to his wife for property of undisclosed value, all took place during fiscal 1955–1956 (Pet. App. A25–A26). Section 501(c)(3) provides that "no part" of the net earnings may inure to the benefit of any individual. The mere fact that in later years petitioner diverted larger sums to individuals cannot save its exemption in the earlier year when a smaller amount was diverted. Fiscal 1955–1956 was petitioner's first year and its earnings were smallest in that year, so there were fewer total funds to divert. But the diversions of funds to private individuals were sufficient to disqualify the corporation from the exemption. See *Spokane Motorcycle Club* v. *United States*, 222 F. Supp. 151, 153–154 (E.D. Wash.).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.
JOHNNIE M. WALTERS,
Assistant Attorney General.
MEYER ROTHWACKS,
LEONARD J. HENZKE, JR.,
Attorneys.

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